Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Gilmore	Analyst:	Angela Raygoza	Bill Number:	AB 675
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	February 25, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Qualified Tuition Program Deduction

SUMMARY

This bill would allow a personal income tax deduction for contributions made to a Qualified Tuition Program (QTP), as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage taxpayers to save for future educational expenses for themselves or their dependents.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other deductions for such things as expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and the portion that exceeds 2 percent of adjusted gross income[1] (AGI) may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

[1] For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

Board Position:			Department Director	Date
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Under federal law, Internal Revenue Code (IRC) section 529 provides tax-exempt status to QTPs. QTPs are programs established and maintained by a state, an agency, or an eligible educational institution to purchase tuition credits or make cash contributions on behalf of designated beneficiaries. Contributions to a QTP on behalf of any beneficiary cannot be more than the amount necessary to provide for the qualified higher education expenses of the beneficiary. Contributions made to a QTP are not deductible and distributions to a beneficiary are excluded from income.

California law conforms to federal law as it relates to tax-exempt QTPs.

THIS BILL

Under the Personal Income Tax Law (PITL), beginning on or after January 1, 2009, this bill would allow qualified taxpayers an income tax deduction equal to the lesser of the amount contributed to a QTP under section 529 of the IRC or the amounts specified by this bill during the taxable year.

This bill specifies the deduction would be an itemized deduction that would not be subject to the 2 percent floor.

This bill specifically sets a limit on the amount of contributions eligible for the deduction as follows:

- $3,000--Single or Married individuals filing separately, and
- $6,000--Married individuals filing jointly and Heads of Household

This bill defines “Qualified taxpayer” as an individual who, on behalf of a beneficiary, contributes money to a QTP and meets all the other applicable requirements of Section 529 of the IRC.

This bill would require the deduction to be taken in the taxable year that the contribution would be made.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

SB 323 (Oropeza, 2009/2010) would allow taxpayers to direct an amount in excess of their tax liability to a Qualified Tuition Program account. This bill is currently in the Senate Revenue and Taxation Committee.

AB 819 (Runner, 2007/2008) was similar to this bill in that it would have allowed a deduction for contributions made by a qualified taxpayer to certain QTPs. AB 819 failed passage out of the Assembly Revenue and Taxation Committee.

SB 643 (Florez, 2007/2008) would have allowed a deduction for contributions made by a qualified taxpayer to a QTP and require the Scholarshare Investment Board to make a one-time contribution to certain QTPs. This bill failed passage out of the Senate Revenue and Taxation Committee.

SB 30 (Speier, 2005/2006) and AB 3 (Blakeslee, 2005/2006) were similar to this bill in that they would have allowed qualified taxpayers a deduction for contributions made to a QTP. SB 30 failed passage out of the Senate Revenue & Taxation Committee; AB 3 failed passage out of the Assembly Revenue & Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not offer an incentive to contribute to QTPs.

Illinois has a College Savings Pool program named "Bright Start." A deduction is allowed from an individual's adjusted gross income for contributions made to the College Savings Pool.

Massachusetts and *Minnesota* conform to federal treatment of QTPs under IRC section 529; contributions to a QTP are not deductible.

Michigan has the *Michigan* Education Savings Program and the *Michigan* Education Trust. A contribution to either one of these programs is exempt from personal income tax up to $5,000 for an individual return, or $10,000 for a joint return.

New York has the *New York* State College Savings Program in which an account owner may deduct contributions made to one or more family tuition plans from federal adjusted gross income in computing *New York* adjusted gross income.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 675 Effective for Taxable Years Beginning On or After January 1, 2009 Assumed Enacted After June 30, 2009 ($ in Millions)		
2009-10	2010-11	2011-12
-$25	-$29	-$35

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of contributions to QTPs deducted on tax returns each year and the marginal tax rate of qualified taxpayers reporting those deductions.

Data from the College Savings Plans Network indicates contributions made by California taxpayers to IRC 529 plans are estimated to total $1.1 billion during tax year 2009. These contributions are reduced by 15 percent to approximately $935 million [$1.1 billion x (1-15%)] to exclude contributions that would exceed the $3,000 and $6,000 contribution limitation under this bill.

Qualified contributions of $935 million are reduced by 50 percent to approximately $467 million ($935 million x 50%) to represent taxpayers who report itemized deductions. As this would be a State-only deduction, it would be anticipated that approximately 75 percent of eligible contributions or approximately $350 million ($467 million x 75%), would be deducted on tax returns for the first year. In each subsequent year, contributions deducted on tax returns are anticipated to increase because of growth in the number of QTP accounts and increased knowledge of the deduction.

Applying a 6.25 percent average marginal tax rate to the estimated deductible contributions of $350 million results in a revenue loss of approximately $22 million ($350 million x 6.25%) for tax year 2009 and a loss of $27 million for tax year 2010. Estimates in the chart reflect revenue on a fiscal year cash-flow basis. For example, the 2009-10 cash flow estimate of -$25 million consists of -$22 million for tax year 2009 and -$3 million for tax year 2010.

LEGISLATIVE STAFF CONTACT

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